The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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The EMS Adjusts . . .

The realignment of several currencies in the European Monetary System (EMS) last week created very little disturbance in the international financial markets. The markets' response was ambivalent; a small decline in the value of the dollar against the EMS currencies was as much due to lower U.S. interest rates as to the new alignment. Further, the realignment had been widely anticipated, the changes in intra-EMS parities involved fewer currencies than expected and the percentage by which the currencies changed was smaller than expected. The German mark and the Dutch guilder were each boosted by 5.5 per cent above their previous central rates in the EMS while the French franc and the Italian lira were each depreciated three per cent against their previous central rate.

The other member currencies in the EMS—the Belgian franc, the Danish krone and the Irish pound did not change. It had been expected that these countries, particularly Belgium, would use this opportunity to adjust their currencies as well. Further, many thought that the German mark would revalue by about ten per cent against the weakest EMS currencies, reflecting the relatively more favorable economic performance of the German economy. For these reasons, another realignment, probably within a year, may well occur once the effects of this "mini-adjustment" can be evaluated.

. . . To Inflation Rate Spreads

Primarily, the readjustment of the intra-EMS exchange rate relationships was made necessary by the wide range of economic performance, particularly inflation rates, among its members. Large variations in either rates of growth or inflation make exchange rate stability impossible to achieve. This was the lesson which the collapse of the Bretton Woods system of fixed exchange rates taught. Then, the exchange rates between major currencies were rigidly fixed. When insuperable pressures developed within the Bretton Woods system, sudden and destabilizing currency adjustments took place, requiring wrenching policy changes.

Frequently, the exchange rate movements were large and the change in currency relationships resulted in the dislocation of existing trade and capital flow patterns. In addition, as pressures on a particular currency increased, speculation against that currency was encouraged, leading to costly and ultimately futile defensive measures by central banks. In the 1960s, serious international financial crises became more frequent, heralding the demise of the fixed rate system. Between 1967 and 1973 there were 11 occasions when crises forced a particular nation to suspend foreign exchange transactions temporarily.

Under the present floating rate system, such pressures tend to be diffused by small daily market readjustments. However, the EMS, a system of semi-fixed rates, limits the range of automatic adjustment in response to market forces. At present, there is a wide variation in inflation rates among the EMS members. Inflation in West Germany, for example, is currently running at an annual rate of close to six per cent while France's inflation rate is over 13 per cent and Italy's is about 20 per cent. It is unlikely that these widely divergent inflation rates will narrow in the near future. Therefore, further, possibly more profound, realignments will be necessary. The utility and viability of the EMS itself may be affected.

The Bretton Woods system collapsed just ten years ago when the United States suspended the convertibility of the dollar into gold in August, 1971. This was a tacit admission that it was no longer possible for even the most powerful nation to defend a fixed exchange rate in the face of declining economic performance. Attempts were made to patch up the system, resulting in the short-lived Smithsonian Agreement of pegged exchange rates which expired in the inflationary boom of 1973. Since then, floating rates have prevailed in recognition of the fact that exchange rate stability is inconsistent with divergent economic performance.

No Clear Trend In U.S. Trade

In spite of the strong appreciation of the dollar this year, U.S. exports and imports have remained

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remarkably stable. For the first eight months of this year, the U.S. trade deficit was a seasonally adjusted $26.2 billion (exports, f.a.s./imports, c.i.f.) compared with $27.3 billion for the same period in 1980. At the same time, the dollar has appreciated on a trade-weighted basis by close to 14 per cent. Total exports in August amounted to $19.1 billion, 1.2 per cent above the $18.8 billion registered in January of this year. Imports in August were $24.7 billion, 1.7 per cent above the $24.3 billion January figure. The $5.6 billion August deficit was only slightly above the January deficit of $5.4 billion—scarcely conclusive evidence of a progressive deterioration of the U.S. trade balance.

The appreciation of the dollar has been widely expected to bring in its wake plunging exports as their prices in foreign currency terms rise and skyrocketing imports as their cost falls in dollar terms. So far, these trends are not clearly evident. It is probable that the decline in U.S. exports and rise in imports will be less drastic than the appreciation of the dollar would imply. Because many U.S. export items are capital goods which often have a long lag between order and delivery, the deleterious effect on exports of an appreciating currency has been delayed. In those export categories usually associated with consumer type goods, a monthly decline in the value of exports has been evident. But many U.S. exports are relatively price insensitive—that is, price is not the primary criterion which determines demand for them. Many exports,

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 9/30/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies			
Owned Outright & RPs	132.017	– .899	+ 1.320
Loans to Depository Inst.	1.446	–0–	– .427
Float	2.727	– .758	– .619
Total Reserve Bank Credit	145.036	– 1.322	+ 3.541
Treasury Deposits with Federal Reserve Banks	3.421	+ .069	– .847
Currency Outside Banks	121.751	– 2 367	+ 4.549
Member Bank Reserves:			
Required	41.009	+ .618	– .875
Excess (Deficiency)	.494	+ .216	+ .144
Total Reserves Held	41.503	+ .834	– .731
Net Borrowed Reserves	.721	– .217	– .761
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	91.462	– .212	+ 7.083

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1-B	429.3	+ 3.1‡	+ 4.7‡
M2 (September '81)	1,786.6	+ 8.5	+ 8.6
M3 (September '81)	2,131.8	+ 10.2	+ 11.4
L (June '81)	2,502.7	+ 9.4	+ 11.4

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 10/9/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	14.25%	13.55%	13.25%
* Federal Agencies	14.35	14.65	15.50
* Project Notes–Taxfree (46% Taxable Equivalent)	15.93	16.39	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	15.35	15.75	16.90

‡Finance Company Paper–Prime

5- 14 days	14.25%
15- 29 days	14.63
30- 59 days	14.63
60- 89 days	14.63
90-179 days	14.50
180-239 days	14.25
240-270 days	14.25

‡* Bankers' Acceptances

Nov.	14.55%
Dec.	14.70
Jan.	14.80
Feb.	14.80
Mar.	14.75
Apr.	14.65

‡Industrial Paper–Prime

30- 89 days	14.38%
90-120 days	14.75

†Federal Funds Effective Rate 14.70%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'81	$ 2,886	$ 2,853	$ 2,565
Gross National Product (1972 Dollars)*	2nd Q'81	$ 1,510	$ 1,516	$ 1,463
Percent Change, Annual Rate	2nd Q'81	– 1.6%	8.6%	– 9.9%
Change in Consumer Prices (all urban consumers)*	Aug '81	9.6%	14.4%	9.6%
Change in Producer Prices*	Sept '81n	2.4%	3.6%	3.6%
Civilian Employment (Thousands of Persons)†	Sept '81	98,270	98,944	97,180
Unemployment as % of Civilian Labor Force†	Sept '81	7.5%	7.2%	7.4%
Personal Income*	Aug '81	$ 2,446	$ 2,419	$ 2,179
Leading Indicators Composite Index (1967=100)†	Aug '81	133.8	134.5	130.7
Industrial Production Index (1967=100)†	Aug '81	152.8	153.4	142.2
Net Change in Consumer Installment Credit†	Aug '81n	$ 2.86	$ 1.95	$ 0.49
U.S. Merchandise Trade Balance†	Aug '81	–$ 4.48	–$ 0.54	–$ 0.63
Plant and Equipment Expenditures*	4th Q'81	$332.69(a)	$322.88(a)	$299.58
Private Housing Starts (Thousands of Units)*	Aug '81	937	1,049	1,411
New Construction Expenditures*	Aug '81	$ 231.0	$ 234.8	$ 217.9
Total Business Inventories†	Jul '81	$ 499.5	$ 494.2	$ 466.8
Total Business Sales†	Jul '81	$ 354.6	$ 354.4	$ 315.6

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

particularly the capital items, are unique and create their own market. Other exports (wheat, for example) compete on world markets with other sources of supply and are sold at a common world price.

A trend toward increased imports is easier to discern. Although the value of August imports is just slightly above the January level, every major import category showed a monthly increase in August over July. In addition to oil imports, manufactured goods and machinery and transport equipment also rose sharply in recent months. But slow growth in the U.S. economy and high interest rates will discourage too rapid growth of imports. Further, import prices have not fallen commensurate with the appreciation of the dollar. Imports have not become significantly cheaper in most cases.

But, there is real risk in assigning too much importance to monthly changes in trade figures. These figures have fluctuated erratically from month to month since the beginning of the year. For example, imports of mineral fuels and lubricants jumped 21.1 per cent from July to August, yet the value of the August fuel imports was five per cent below the June figure.

Before year-end however, the effects of the strong dollar on U.S. foreign trade will become apparent leading to a trade deficit slightly larger than last year's $36.4 billion. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (9/23/81)	130,026	+ 1,772	+32,897
New York City (9/23/81)	31,170	+ 247	+ 8,473
Commercial Paper (9/23/81)	163,830	+ 3,576	+42,270

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/23/81)	185,020	– 164	+21,630
New York City (9/23/81)	53,878	– 305	+ 5,952

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/23/81)	450,890	– 2,041	+46,028
New York City (9/23/81)	106,945	– 1,417	+14,973

Financial Markets

	Friday 10/9/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	13.70%	– 1.30	+ 2.00
180-Day Bills†	14.62	– 1.23	+ 2.52
Longest Bills†	14.85	– 1.18	+ 1.90
Recent Issues:			
16s 9/30/83	15.00	– 1.35	
15⅞s 9/30/85	15.02	– .28	
14⅞s 8/15/91	14.60	+ .13	
13⅞s 5/15/11	14.11	+ .51	
Municipals:			
Bond Buyer–20 Bond Index* (10/8/81)	12.73%	– .20	+ 3.72
Blue List Total ($ Million)	$ 804	+ $ 68	+ $ 198
30-Day Visible Supply ($ Million)	$1,898	+ $ 67	– $ 724
Total	$2,702	+ $135	– $ 526
Corporates:			
Moody's Aa Composite (10/8/81)	15.72%	– .74	+ 3.15
30-Day Visible Supply ($ Million)	$7,629	– $ 95	+ $3,573
Stocks:			
Dow-Jones Averages:			
Industrials	873.00	+ 12.27	– 77.68
Transportation	371.28	+ 5.84	+ 21.20
Utilities	104.16	+ 1.35	– 8.95
65 Stocks	342.15	+ 4.93	– 12.68
Standard and Poor's 500 Stocks	121.45	+ 2.09	– 8.84
N.Y.S.E. Composite Index	70.32	+ 1.46	– 5.02
N.Y.S.E. Avg. Daily Vol. for Week (000's)	48,862	– 814	+ 1,806

* 46% Taxable equivalent 23.57%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/9/81	Week Ago
Overnight	14.88%	16.25%
1 month	15.31	16.75
3 month	16.25	17.63
6 month	16.38	17.94
1 year	16.25	17.38
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	15.50%	15.80%
Long Term (7 to 15 yrs.)	15.50	15.70

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/9/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02726	36.68
Canada	.8354	1.1971
Denmark	.1418	7.0525
France	.1824	5.4825
Germany	.4574	2.1865
Italy	.0008572	1166.50
Japan	.004407	226.90
Mexico	.03946	25.34
Netherlands	.4136	2.4180
Switzerland	.5435	1.8400
U.K.	1.9043	.5251

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